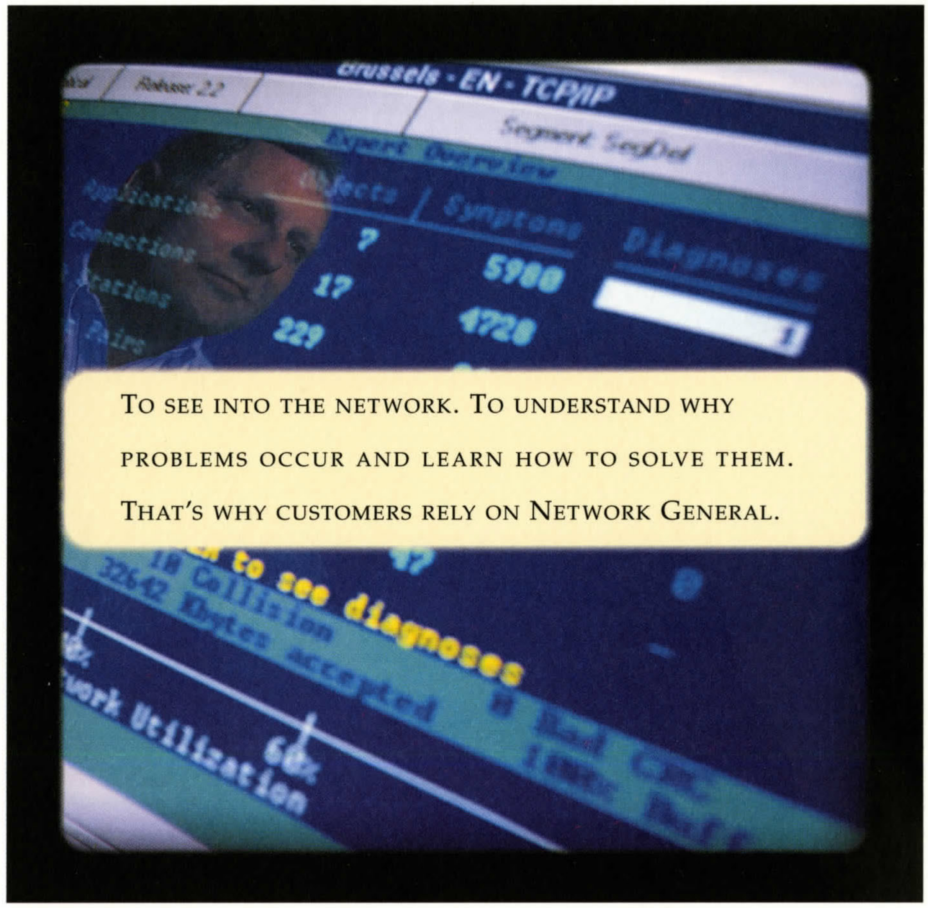
Network General Corporation



1995 Annual Report

Network General

For most companies today, the role of the network is changing dramatically. As companies migrate more of their critical business applications and data to distributed information systems, the network is evolving from a technological necessity to a strategic business resource.

To maximize this resource, these companies need constant visibility into their network's operation and confidence in its performance. At Network General, our business is providing this visibility and confidence.

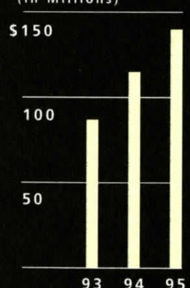
As networks expand and proliferate, they form an increasingly complex web of technology, systems, applications and protocols – often spread over multiple locations. The resulting network environments contain an infinite number of potential points of failure. To identify, diagnose and resolve their network problems, thousands of companies worldwide rely on Network General, the leader in network fault and performance management.

Financial Highlights

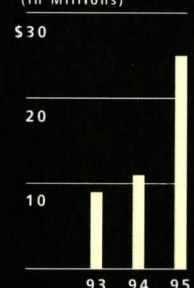
(In thousands, except per share amounts)	1995	1994	1993	1992	1991
Revenues	$139,755	$114,900	$86,483	$64,065	$47,945
Net Income	$ 25,411	$ 11,276	$ 8,645	$ 4,274	$ 5,465
Earnings Per Share	$ 1.14	$ .53*	$ .44	$ .26	$ .35

*Exclusive of restructuring and merger-related expenses, earnings per share for the year ended 3/31/94 would have been $.74

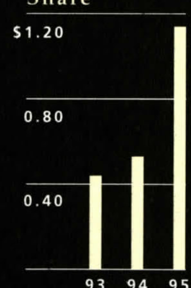
Revenues
(In Millions)



Net Income
(In Millions)



Earnings per Share



Systems:

Network General Distributed Sniffer System® products deliver a comprehensive fault and performance management solution, enabling our customers to manage complex, geographically-dispersed networks from centralized locations. Network General's Foundation Manager™ Remote Monitoring (RMON) capabilities enable customers to continuously monitor the health of their network using standards-based solutions.

Distributed Sniffer System Products

- Sniffer® Servers
  - Ethernet
  - Token Ring
  - Sniffer Internetwork Server
  - FDDI
- SniffMaster® Consoles
  - UNIX® (AIX, Solaris®, HP-UX)
  - Windows®

RMON Products

- Foundation Manager Console
  - OS/2®
  - Windows
- Foundation Manager Agent/Probe

Application

- Network General® Reporter

Tools:

Running on industry-standard PCs, instead of expensive, proprietary hardware, Network General's family of Sniffer Network Analyzer™ products provides customers the industry's most comprehensive tools to perform cost-effective network monitoring and analysis. Their portability makes them ideal for field diagnostics, minimizing network downtime and expensive site visits. With the ability to decode more than 200 networking protocols and analyze all levels of network performance, these analyzers help network managers predict and prevent potential problems. If a problem does occur, these tools not only trace the problem to its source — they also recommend corrective actions.

Expert Sniffer Network Analyzer™ Products

- Notebook Sniffer Analyzers
  - Token Ring
  - Ethernet
- Sniffer Lite™ for NetWare™
- Portable Sniffer Analyzers™
  - Token Ring
  - Ethernet
  - Sniffer Internetwork Analyzer™
  - FDDI

Services:

To help customers maximize both their Network General investments and their network's performance, the Company provides a wide range of customer services, from software updates and toll-free technical support to extended support service options. In addition, Sniffer University™ provides courses in all phases of network management — from planning and analysis to troubleshooting. And for either on-site or remote consultation, the LANGuru® consulting program offers a full range of network expertise, from problem diagnosis to strategic network planning.

- PrimeSupport℠
- Sniffer University
- LANGuru
- Information Services
  - World Wide Web
- Certified Network Expert™

To Our Shareholders

During the year ended March 31, 1995, Network General strengthened its position as the leading supplier of network troubleshooting, monitoring and analysis software and services. We continued to focus on the needs of our customers and were rewarded with record financial performance and broader market penetration.

At the same time, we launched initiatives designed to expand the Company's presence in this dynamic market. Our position as the leading supplier of tools and systems for enterprise fault and performance management has created the opportunity for the Company to become an even more integral part of our customers' networks.

Record Financial Results Fiscal 1995 was a very good year for the Company. Revenues grew to $139,755,000 from fiscal 1994 revenues of $114,900,000. Earnings growth outpaced the Company's revenue gains. Net income was $25,411,000, or $1.14 per share, versus $11,276,000, or $.53 per share, in fiscal 1994. Exclusive of restructuring and merger-related costs, earnings per share in fiscal 1994 would have been $.74.

We improved our leverage of expenses during fiscal year 1994. Sales and marketing expenditures were 34 percent of total revenues, down from 37 percent in fiscal 1994. At 7 percent of total revenues, general and administrative expenditures were flat compared to 1994. Indicative of our commitment to the future, the Company continued to make healthy investments in its research and development efforts, increasing expenditures 29 percent over 1994 levels.

Market Environment The use of networks to support enterprise and mission–critical tasks has exploded. The dream of the globally connected company has become a reality. Network performance, availability and reliability are no longer "nice to have"— they are critical to most organizations.

In addition, networking technology has continued to evolve rapidly. The role of the network manager is being further complicated with the emergence of more complex, network-based applications, the convergence of wide area networks (WANs) and local area networks (LANs), the dramatic rise in the corporate use of the Internet and World Wide Web and the need to support more network-based software applications and users.

New Products and Services During the year, we introduced enhancements to the Company's core product line to support new topologies and increasingly sophisticated market demands. The most significant of these product developments was the shipment of the first in a series of products designed to provide a comprehensive solution for monitoring and analyzing database transactions in a distributed LAN or WAN client/server environment — the first product of its kind in the market.

The acquisition of ProTools a year ago enabled the Company to establish a presence in the Remote Monitoring (RMON) market. During the year, we began shipping a new Windows-based version of our RMON products, Foundation Manager, along with our RMON agent/probe. We will broaden our penetration into the RMON market with Foundation Manager for UNIX along with additional probe capabilities in this fiscal year.

The Future We are pleased with our many accomplishments, and we see additional opportunities for the Company to continue its revenue growth. In the months and years ahead,

the use of switched Ethernet, Fast Ethernet, and ATM (asynchronous transfer mode) as the basis for network infrastructure will become market factors. We plan to assist organizations in dealing with the issues of fault and performance management of these new networking infrastructures with the best products and services available.

While Network General continues to lead the network fault and performance management market, we cannot rest on our past accomplishments. As we begin a new fiscal year, I am confident that we have the resources and technological expertise to expand the depth and breadth of our leadership position by providing the total solution for enterprise fault and performance management in the client/server world.

Thank you for your continued support.

Leslie G. Denend

Leslie G. Denend
President and Chief Executive Officer
Network General Corporation
June 2, 1995

For most businesses today, the question of how well — and how fast — their networks run is no longer a matter of technological interest. With downtime or slow response times often translating into missed opportunities and lost revenues, network performance is now a matter of bottom-line concern.

In the following pages we'll look at the rapid evolution of networking, and the strategic role that Network General plays in this constantly changing industry. And we'll look at how three customers have employed Network General solutions to more effectively manage their networks and improve their network performance.

Networking Trends and the Network General Strategy

Today's networks are in the midst of a fundamental change. From supporting the structured world of mainframes to enabling today's client/server computing, the network has emerged as the backbone of today's information systems. In the same process, however, networks have also become an increasingly complex, intimidating mixture of systems, databases and applications, each with their own unique set of protocols and problems.

As businesses and organizations scramble to keep pace with these changes, they turn to Network General, with its nearly ten years of experience in network analysis and trouble-shooting technology, for the systems, tools and support that are designed to provide maximum network performance. As the networking industry has evolved, Network General has consistently led the way, setting the standard in fault and performance management.

The Move to Distributed Enterprise Networks Today's complex networks can trace their origins to the Local Area Networks (LANs) and the confusing, intimidating mixture of hardware, software and network protocols they posed to network managers. Recognizing the depth of this problem and its impact on network operations, Network General pioneered the industry–leading Sniffer technology. With its sophisticated Expert Analysis and trouble-shooting capabilities, Sniffer technology gave network managers the capability to monitor and analyze network activity, identifying symptoms before they became problems, and tracing those problems — wherever they occurred on the network — back to their source.

Applications Place New Stress on the Network Today, companies looking to link their desktops and LANs into a distributed computing system are turning to a new architecture, enterprise client/server computing. Coupling the benefits of new high-speed computers with the familiarity and ease-of-use of graphic front–ends — all the while preserving companies' mainframe investments — client/server has emerged as the new standard in information systems.

As companies migrate their most important — and most data-intensive — applications to client/server, the network becomes increasingly strained. The multiple types of hardware, software and network protocols that make up a typical client/server network translate into multiple points of failure, creating concerns about network performance and uptime, data reliability and consistent quality of service across the entire network.

Network General is responding to the intricacies of client/server analysis by developing solutions that specifically address the issue of application performance. An example is the recent introduction of the Database Module for Oracle7™, an industry first which gives network managers insight into the interaction between the client application, the server, the database and the network itself. This new technology provides network managers with a product that is designed to provide maximum database and application performance in the new client/server architecture.

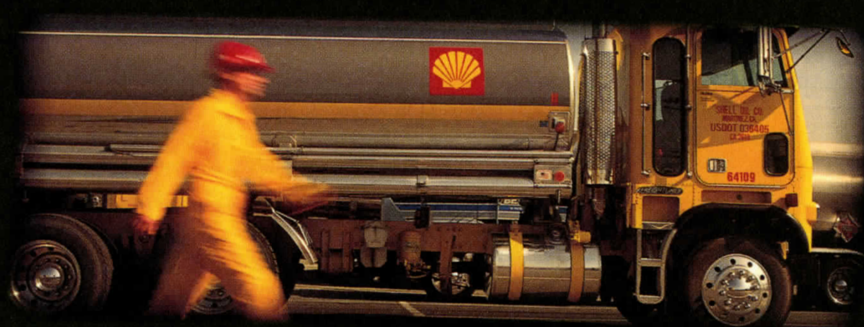
Networking a Changing Workplace In addition to supporting changing computing architectures, today's networks also have to support radical changes in the way companies work and communicate. The moves to telecommuting and mobile offices — as well as the new trend to flatten organizations composed of constantly changing workgroups — have introduced the terms "remote" and "virtual" to the networking vocabulary. These new network segments, many requiring new links to the Wide Area Network (WAN), create additional stress on the network.

To deal with this expanding network environment, network managers need a distributed management system with the flexibility to match their changing organizations.By deploying servers and agents at critical points across the network, then reporting relevant network activity on both local and remote segments, Network General's Distributed Sniffer System product lets network managers monitor and control all levels of their networks. And as the organization changes, the Distributed Sniffer System product can be configured to reflect those changes, while still providing control from a single, centralized console.

Next Generation Networks Networking's capabilities are currently being tasked with increasingly large and complex applications — such as the increased use of video and multimedia in the education market, the use of imaging by hospitals to do remote diagnostics and treatment, and desktop videoconferencing. These new high-bandwidth applications put incredible stress on current networks and are the driving forces behind the next generation in networking: switched networks. With switched technology, network managers can define their physical networks once, then restructure the network "virtually" — with software instead of rewiring — to accommodate the demands of the new applications and changing workforce.

Individually and in partnership with other vendors, Network General is again taking the lead in fault and performance management for this next generation of networks. By supporting these emerging high-speed technologies — from 100 Mbps Fast Ethernet to ATM — Network General will help customers diagnose and address the problems stemming from switched internetworking. By partnering with major switch vendors to develop management interfaces to their products, Network General is providing its customers with the systems, tools and services to achieve maximum performance from both their current and future networks.

THE DISTRIBUTED SNIFFER SYSTEM ALLOWS SHELL OIL TO SOLVE PERFORMANCE PROBLEMS AT ANY POINT ON THE NETWORK—ALL FROM A SINGLE LOCATION.



The world of oil runs on data. From exploration to transportation to manufacturing to tracking dealer and customer sales, the oil industry depends on networks to transport its immense volumes of data.

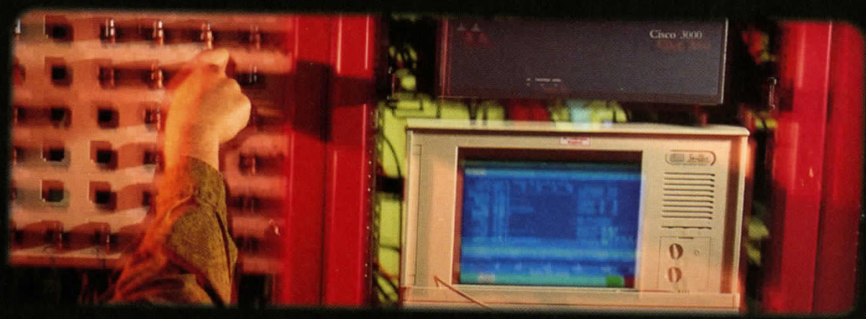
Shell Oil maintains one of the largest and most sophisticated networks in the world, with all of its business components — from oil field discovery to customer billings — integrated into a single information system. The Shell network consists of 22,400 computers spread over 225 sites, with 250 Vsat (very small aperture terminal) satellite stations in remote locations. In addition to its normal monthly load of more than 34 terabits of information, the network also carries more than 500 hours of videoconferencing.

To gain visibility into this complex global network, Shell relies on one tool over all others. Network General's Distributed

Shell Oil

Sniffer System product allows technicians to monitor and analyze sites at the farthest edge of the network — all from a single centralized location. Whereas in the past the company would either have to fly a technician to a problem site — or even station someone there — now the problems are solved more quickly, by more qualified personnel and with significant savings to the company.

To keep its network functioning at peak performance, Shell uses Network General technology to look for trends and potential trouble spots. Sniffer products track traffic patterns, looking for those elements which are unnecessarily burdening the network; they identify protocol issues and trace the problems back to their source; and they identify which applications are creating or experiencing network problems. The result is faster problem analysis, quicker and more accurate decisions, and a network which runs smoothly.



Cisco Systems relies on Sniffer products for their ability to quickly diagnose complex network performance problems and interpret more than 200 different protocols.

When you're the leader in internetworking technology, people look to you for answers to their networking problems, whether they involve your technology or not. Cisco Systems, the leading supplier of high–performance routers, communication servers and router management products, faces that problem daily, as customers call in from all corners of the globe with their networking issues. To help resolve these issues and trace them back to their source, Cisco relies on Network General.

In an average week, Cisco's Technical Assistance Center (TAC) handles more than 2,000 customer calls. Some problems are handled by phone; others are duplicated in the TAC lab. The most difficult problems, however, require that the TAC remotely enter the customer's network — either by modem or via the Internet —

Cisco Systems

and analyze all aspects of the network's performance. And for that they use Network General Sniffer products.

With so many Cisco customers already using Network General products, TAC engineers can use the customer's Sniffer products to capture data related to their problems. In the rare cases where the customer doesn't have Sniffer products, the TAC will ship them one of their own. Cisco software engineers then analyze the captured data, employing Sniffer products to track every byte of code and to modify and test their proposed solution. The approved fix is then forwarded to the customer, along with the data generated from Sniffer products that shows the customer what happened, which products may be conflicting with others and how they can optimize network performance in the future.

AMGEN EMPLOYS SEVERAL NETWORK GENERAL PRODUCTS AND SYSTEMS TO KEEP TRACK OF NETWORK UTILIZATION, NETWORK ERRORS AND TOP TRANSMITTING STATIONS.

In the information-intensive world of biotechnology, where time to market is so important, the timely transfer of data is critical. Amgen, the world's largest independent biotechnology company, discovers, develops and markets products to treat blood disorders and neurodegenerative and inflammatory diseases. To ensure that its research is as thorough and timely as possible, Amgen relies on a complex worldwide network. And to ensure that this network performs at its peak, Amgen uses Network General technology.

The Amgen worldwide network unites far-flung R&D facilities and offshore manufacturing with centralized administration and distribution operations. Consisting of over 100 local LANs and WANs connecting almost 5,000 workstations, the network transports a daily data volume measured in gigabytes, including the transfer of

Amgen

cell research images between centralized databases and remote research facilities.

Amgen network managers utilize Network General's products to monitor and report on all aspects of their network's performance. With Distributed Sniffer Systems products monitoring critical network locations and Foundation Manager agents products collecting RMON (Remote Monitoring) data, network managers use the Network General Reporter products to generate and distribute daily graphic reports to their users, highlighting network utilization, network errors and top transmitting stations. This information is then used to decide which segments need to be split, which sites require more bandwidth and which sites require closer monitoring for preventative action. The result is a smooth-running network and the fulfillment of Amgen's commitment of over 99% uptime.

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Selected Financial Data

Consolidated Statements of Income Data[1, 2]

(In thousands, except per share amounts)

	Year ended March 31, 1995	1994	1993	1992	1991
Revenues	$139,755	$114,900	$ 86,483	$64,065	$47,945
Income from operations	31,768	13,915	10,415	7,386	8,205
Income before cumulative effect of change in accounting method	25,411	11,276	8,645	4,274	6,287
Net income	25,411	11,276	8,645	4,274	5,465
Earnings per share before cumulative effect of change in accounting method	1.14	.53	.44	.26	.40
Earnings per share	$ 1.14	$ .53	$ .44	$ .26	$ .35
Weighted average common and common equivalent shares outstanding	22,313	21,173	19,807	16,437	15,558

Consolidated Balance Sheet Data[1, 2]

(In thousands)

	As of March 31, 1995	1994	1993	1992	1991
Working capital	$101,536	$ 65,457	$ 41,014	$45,065	$37,791
Total assets	196,190	160,846	132,033	66,883	49,601
Long-term obligations	2,225	2,134	1,555	1,026	222
Total stockholders' equity	$165,587	$132,283	$109,562	$51,011	$42,235

Quarterly Financial Data[1, 2] (Unaudited)

(In thousands, except per share and stock price amounts)

Three months ended

	Mar. 31, '95	Dec. 31, '94	Sept. 30, '94	June 30, '94	Mar. 31, '94	Dec. 31, '93	Sept. 30, '93	June 30, '93
Revenues	$39,800	$37,530	$32,375	$30,050	$33,950	$30,831	$26,399	$23,720
Gross profit	30,926	28,808	24,927	23,295	25,568	23,441	19,703	17,152
Income from operations	10,127	9,580	6,489	5,572	2,933	5,724	2,911	2,347
Income before provision for income taxes	11,980	10,810	7,641	6,665	3,918	6,654	3,796	2,885
Net income	8,206	7,408	5,231	4,566	2,156	4,249	3,124	1,747
Earnings per share	$ .36	$ .33	$ .24	$ .21	$ .10	$ .20	$ .15	$ .09
Price range of common stock	$ 30.00- $ 23.50	$ 25.69- $ 18.63	$ 20.00- $ 14.50	$ 20.50- $ 14.25	$ 22.75- $ 16.63	$ 18.00- $ 12.38	$ 14.38- $ 10.13	$ 11.50- $ 8.25

1) Amounts for fiscal year 1993, fiscal year 1992 and fiscal year 1991 have been restated in order to comply with Statement of Position 91-1. The cumulative effect of the change in accounting method for the years prior to fiscal year 1991 was an $822,000 reduction to net income. This is reflected in fiscal year 1991.

2) All periods reflect combined results for Network General Corporation and ProTools, Inc. ("ProTools"), a wholly owned subsidiary of Network General Corporation. ProTools was acquired in January 1994 and the merger was accounted for as a pooling of interests. Accordingly, the financial statements for prior periods have been restated to include the results of ProTools.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Income Statement Highlights

	1995	Change	1994	Change	1993
Revenues	$139,755	22%	$114,900	33%	$86,483
Gross Profit	107,956	26%	85,864	29%	66,426
Percentage of revenues	77%		75%		77%
Operating Expenses	76,188	6%	71,949	28%	56,011
Percentage of revenues	55%		63%		65%
Net Income	25,411	125%	11,276	30%	8,645
Earnings per share	$ 1.14	115%	$ .53*	20%	$ .44

*Exclusive of restructuring and merger-related expenses, earnings per share for the year ended 3/31/94 would have been $.74.

Revenues

The increasing complexity of computer networks has caused greater demand for products that assist network administrators in managing their networks. In general, sales have increased in each geographic territory and across all product segments due to increased demand for the Company's products and services.

Sources of Revenues	1995	Change	1994	Change	1993
Domestic	$108,773	22%	$ 89,216	36%	$65,769
International	30,982	21%	25,684	24%	20,714
Total Revenues	$139,755	22%	$114,900	33%	$86,483

Revenues for the fiscal year ended March 31, 1995 were $139,755,000, an increase of 22% over revenues of $114,900,000 reported for fiscal year 1994. Fiscal year 1994 revenues increased 33% over revenues of $86,483,000 reported for fiscal year 1993. Domestic revenues increased 22% to $108,773,000 for fiscal year 1995, compared to $89,216,000 for fiscal year 1994. Fiscal year 1994 domestic revenues increased 36% compared to $65,769,000 for the year ended March 31, 1993. International revenues increased 21% to $30,982,00 for the year ended March 31, 1995, compared to $25,684,000 in the year ended March 31, 1994. For fiscal year 1994, international revenues increased by 24% compared to $20,714,000 for fiscal year 1993. International revenues represented 22% of total revenues for the years ended March 31, 1995 and March 31, 1994, compared to 24% for the year ended March 31, 1993.

Sources of Revenues	1995	Change	1994	Change	1993
Tool Products	$ 73,114	15%	$ 63,714	20%	$53,091
Percentage of total revenues	52%		55%		61%
System Products	39,872	20%	33,259	62%	20,497
Percentage of total revenues	29%		29%		24%
Subtotal Product Revenues	112,986	17%	96,973	32%	73,588
Percentage of total revenues	81%		84%		85%
Services	26,769	49%	17,927	39%	12,895
Percentage of total revenues	19%		16%		15%
Total Revenues	$139,755	22%	$114,900	33%	$86,483

Tool products include revenues from the Sniffer Network Analyzer products, the PCI line of Wide Area Network (WAN) analysis products, product rentals and royalties from license agreements. System products consist of revenues from the Distributed Sniffer System analysis products and from the Distributed Sniffer System Monitoring products (formerly ProTools Network Control Series). Service revenues include first-year warranty revenues as defined by SOP 91-1 and revenues from software support and maintenance contracts, training and consulting services.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The Company's tool products revenues increased 15% in the year ended March 31, 1995 to $73,114,000 from $63,714,000 in the year ended March 31 1994. Fiscal year 1994 tool products revenues increased 20% from $53,091,000 reported for the year ended March 31, 1993. Increased sales of the Company's Sniffer Network Analyzer products were responsible for most of the increase in tool products revenues in both years. Tool products revenues represented 52% of total revenues in fiscal year 1995 compared to 55% in fiscal year 1994 and 61% in fiscal year 1993. Tool products revenues declined as a percentage of total revenues due to faster growth in both system products revenues and service revenues during fiscal year 1994 and due to faster growth in service revenues in fiscal year 1995.

System products revenues in fiscal year 1995 increased 20% to $39,872,000 from $33,259,000 in fiscal year 1994. Fiscal year 1994 system products revenues increased 62% from $20,497,000 reported in fiscal year 1993. System products revenues represented 29% of total revenues for the years ended March 31, 1995 and March 31, 1994, and 24% for the year ended March 31, 1993. The increase in system products revenues in both years was a result of increased Distributed Sniffer System analysis products sales, partially offset by a decrease in monitoring product revenues.

For the year ended March 31, 1995, service revenues totaled $26,769,000, an increase of 49% from $17,927,000 in the year ended March 31, 1994. Fiscal year 1994 service revenues increased 39% from $12,895,000 in fiscal year 1993. The increase in service revenues in both years related to increased demand for all categories of services. Service revenues represented 19%, 16% and 15% of total revenues in fiscal years 1995, 1994 and 1993, respectively.

Gross Profit

(As a percentage of related revenues)	1995	1994	1993
Products	79%	76%	76%
Services	69%	69%	80%
Total	77%	75%	77%

Cost of revenues consists of manufacturing costs, cost of services and warranty expenses. Gross profit as a percent of total revenues was 77%, 75% and 77% for the years ended March 31, 1995, 1994 and 1993, respectively. The increase in gross profit as a percent of revenues in fiscal year 1995 compared to fiscal year 1994 was primarily due to decreased tool product platform shipments, which have lower gross margins, and improved margins in system products due to product cost decreases. Service margins decreased in fiscal year 1994 from fiscal year 1993, primarily due to increases in staffing and other expenses in support of increased service revenues.

In addition, gross profit for the year ended March 31, 1995 was favorably affected by 1% as a result of the Company's recognition of an initial fee received pursuant to a distribution agreement with Atelco Ltd. The agreement gives NexTest, Inc., a wholly owned subsidiary of Atelco Ltd., worldwide distribution rights for the Company's PCI line of products in exchange for distribution fees paid to Network General. The Company does not anticipate that future payments pursuant to this distribution agreement will have as significant an impact on gross profit as the initial fee.

Gross profit and gross profit percent may vary as a result of a number of factors, including product mix between tool products, system products and services, third-party computer platforms sales which have lower margins than the Company's own products, and the mix of international and domestic sales.

Sales and Marketing Expenses

	1995	Change	1994	Change	1993
Sales and Marketing Expenses	$47,049	10%	$42,906	16%	$36,867
Percentage of Revenues	34%		37%		43%

Sales and marketing expenses increased 10% in fiscal year 1995 to $47,049,000 compared to $42,906,000 in fiscal year 1994. Fiscal year 1994 expenses increased 16% compared to $36,867,000 in fiscal year 1993. The increase each year was primarily due to increased domestic sales expense for increased staffing, commission expense and promotional activity needed to support increased sales. As a percent of total revenues, sales and marketing expenses were 34%, 37% and 43% for the periods ended March 31, 1995, 1994 and 1993, respectively. Sales and marketing expenses have decreased as a percent of total revenues as a result of increased productivity.

Research and Development Expenses

	1995	Change	1994	Change	1993
Research and Development Expenses	$19,968	29%	$15,534	28%	$12,178
Percentage of Revenues	14%		14%		14%

Research and development expenses increased 29% in fiscal year 1995 to $19,968,000 compared to $15,534,000 in fiscal year 1994. Fiscal year 1994 research and development expenses increased 28% over fiscal year 1993 levels of $12,178,000. Increased expenses in both fiscal years 1995 and 1994 were due to increased staffing in support of development efforts. Research and development expenses as a percent of revenues was 14% in all three years. The Company believes that continued commitment to research and development is required to remain competitive.

Research and development expenses are accounted for in accordance with Statement of Financial Accounting Standards No. 86, under which the Company is required to capitalize software development costs after technological feasibility is established. Capitalizable software development costs incurred to date have not been significant and, thus, the Company has charged all software development costs to research and development expenses in the consolidated statements of income.

General and Administrative Expenses

	1995	Change	1994	Change	1993
General and Administrative Expenses	$ 9,171	17%	$ 7,847	13%	$ 6,966
Percentage of Revenues	7%		7%		8%

General and administrative expenses for the fiscal year ended March 31, 1995 increased 17% to $9,171,000 compared to $7,847,000 for the fiscal year ended March 31, 1994. Fiscal year 1994 expenses increased 13% compared to expenses of $6,966,000 for the fiscal year ended March 31, 1993. As a percent of revenues, general and administrative expenses were 7% for the years ended March 31, 1995 and March 31, 1994, and 8% for the year ended March 31, 1993. Increased staffing and, to a lesser extent, increased use of outside services to support the growth of the Company accounted for the increased spending in both fiscal years 1995 and 1994.

Restructuring and Other Operating Expenses

	1995	Change	1994	Change	1993
Restructuring and Other Operating Expenses	$ —	n/a	$ 5,662	n/a	$ —
Percentage of Revenues			5%		

Restructuring and other operating expenses were $5,662,000 in fiscal year 1994. The majority of these expenses occurred in the fourth fiscal quarter which ended March 31, 1994, and were associated with the acquisition of ProTools, Inc. Total charges associated with the acquisition were approximately $4,903,000. All of these costs were charged against income of the combined company in the fourth quarter of fiscal year 1994. Other expenses of $759,000 in fiscal year 1994 were primarily severance expenses associated with changes in senior management which were effective in the second fiscal quarter ended September 30, 1993. There were no restructuring and other operating expenses for the fiscal years ended March 31, 1995 or March 31, 1993.

Interest Income, Net

	1995	Change	1994	Change	1993
Interest Income, net	$ 5,328	60%	$ 3,338	5%	$ 3,183
Percentage of Revenues	4%		3%		4%

Interest income, net increased to $5,328,000 in fiscal year 1995 compared to $3,338,000 in fiscal year 1994 and $3,183,000 in fiscal 1993. The increase in interest income is primarily a reflection of increased balances of cash, cash equivalents and marketable securities available for investment during each year.

Provision for Income Taxes

	1995	Change	1994	Change	1993
Provision for Income Taxes	$11,685	95%	$ 5,977	21%	$ 4,953
Effective Tax Rate	31.5%		34.6%		36.4%

The provision for income taxes was 31.5% of pretax income for the fiscal year ended March 31, 1995, compared to 34.6% for the fiscal year ended March 31, 1994 and 36.4% for the fiscal year ended March 31, 1993. The decrease in the effective tax rate in fiscal year 1995 compared to fiscal year 1994 was primarily due to ProTools' operating losses which were not realized for tax purposes in fiscal year 1994. In addition, the tax effect of the expenses associated with the acquisition of ProTools in the fourth quarter of fiscal year 1994 increased the provision rate in fiscal year 1994, since a portion of those expenses were not tax deductible.

The decrease in the effective tax rate in fiscal year 1994 compared to fiscal year 1993 reflects the benefits derived from the Company's Foreign Sales Corporation, research and development tax credits and investment in tax-exempt instruments. In addition, a non recurring reduction to the provision of $650,000 was the result of Federal tax legislation which became effective in the second quarter of fiscal year 1994. The new legislation provides for the tax deductibility of intangible assets which were acquired in prior periods and were previously held to be not tax deductible. The new legislation also reinstated the tax credit for research and development retroactive to the third quarter of fiscal year 1993.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Earnings Per Share

	1995	Change	1994	Change	1993
Earnings per share	$1.14	115%	$.53*	20%	$.44

*Exclusive of restructuring and merger-related costs, earnings per share for the year ended 3/31/94 would have been $.74.

Earnings per share for the year ended March 31, 1995 were $1.14, an increase in earnings per share of 115% compared to $.53 per share earned in fiscal year 1994. Earnings per share in fiscal year 1994 increased 20% compared to earnings per share of $.44 in fiscal year 1993. Earnings per share in fiscal year 1994 were affected by two non recurring transactions: 1) earnings were reduced by approximately $.02 per share in the second quarter of fiscal year 1994 as a result of expenses associated with changes in senior management, and 2) earnings were reduced by approximately $.17 per share in the fourth quarter of fiscal year 1994 as a result of expenses associated with the acquisition of ProTools.

Liquidity and Capital Resources

	1995	1994	1993
Cash, Cash Equivalents and Marketable Securities	$ 92,914	$55,559	$31,108
Long-Term Investments	$ 52,410	$57,480	$59,800
Working Capital	$101,536	$65,457	$41,014

Cash, cash equivalents and marketable securities increased $37,355,000 and $24,451,000 in fiscal years 1995 and 1994, respectively. The primary source of these funds was cash provided by operating activities, as well as proceeds from the issuance of common stock.

Net cash generated from operations in fiscal year 1995 was $33,144,000 compared to $20,244,000 for fiscal year 1994, and $10,856,000 for fiscal year 1993. The primary source of these funds was net income before depreciation and amortization for all periods shown. The net increase in fiscal year 1995 also reflects increases in deferred revenue and reductions in deferred taxes and accounts receivable, partially offset by an increase in inventories and prepaid expenses. Cash provided by operating activities in fiscal year 1994 reflects increases in deferred revenue and a reduction in inventories, partially offset by an increase in deferred taxes and accounts receivable.

Net cash used in investing activities was $26,373,000 and $33,036,000 during fiscal years 1995 and 1994, respectively. The Company used $17,621,000 and $25,544,000, in fiscal years 1995 and 1994, respectively, primarily to increase investments in marketable securities. In fiscal year 1993, the Company used $61,790,000 in cash for investing activities, primarily to increase long-term investments, of which approximately $46,000,000 was proceeds from the Company's public stock offering in April 1992.

Net cash provided by financing activities was $7,893,000 and $8,806,000 for fiscal years 1995 and 1994, respectively. The primary source of those funds was the exercise of employee stock options. During fiscal year 1995 the Company repurchased 395,000 shares of its common stock at an average price of $22.16 for a total cash outlay of $8,755,000. As of March 31, 1995, the Company was authorized to repurchase an additional 605,000 of its shares on the open market. The Company anticipates that it will continue its systematic share repurchase program.

As of March 31, 1995 the Company's principal sources of liquidity included, cash, cash investments, marketable securities and long-term investments totaling $145,324,000, including $52,410,000 in long-term investments. Included in marketable securities at March 31, 1995 are approximately $2,000,000 of Orange County, California Tax and Revenue Anticipation Notes. The company currently has no information which indicates that the principal and accrued interest will not be repaid and has made no provision for a loss on the investment.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities", on a prospective basis in the first quarter of fiscal year 1995. In accordance with SFAS No. 115, the Company has classified all marketable debt securities and long-term debt investments as held-to-maturity and has accounted for these investments at amortized cost. Accordingly, no adjustment for unrealized holding gains or losses have been reflected in the Company's financial statements.

The Company currently has no outstanding bank borrowings and has no established lines of credit. The Company believes that cash generated from operations, together with existing cash and investment balances will be sufficient to satisfy operating cash and capital expenditure requirements through at least the next twelve months.

Business Risks

The Company's future operating results may be affected by certain factors and trends of its market which are beyond its control. The market for Network General's products is characterized by rapidly changing technology and evolving industry standards. Included in such changes is the development of asynchronous transfer mode ("ATM") for the transmission of data along local area and wide area networks, as well as other switching technologies. Network General believes that its future success will depend, in part, on its ability to continue to develop, introduce and sell new products. The Company is committed to continuing investments in research and development; however, there is no assurance that these efforts will result in the development, timely release or market acceptance of new products.

In addition, the Company's results may be adversely affected by the actions of existing or future competitors including established and emerging computer, communications, intelligent network wiring, network management and test instrument companies. There can be no assurance that Network General will be able to compete successfully in the future with existing or future competitors.

Network General does not carry a significant level of backlog. The majority of the Company's revenues in each quarter are a result of orders booked in that quarter. Expense levels are based on expectations of future revenues. Expense levels would be disproportionately high in the event of a decrease in near-term demand for the Company's products and would therefore have an adverse affect on the Company's operating results.

For certain critical components of its products, Network General relies on a limited number of suppliers. In addition, some of the Company's products are designed around specific computer platforms which are only available from certain manufacturers. As a result of product transitions by these computer platform manufacturers, the Company has found it increasingly necessary to purchase and inventory computer platforms for resale to its customers. Any significant shortage of computer platforms or other critical components for the Company's products could lead to cancellations or delays of purchases of the Company's products which would materially and adversely affect the Company's operating results. If purchases of computer platforms or other components exceed demand, the Company would incur expenses for disposing of the excess inventory, which would also adversely affect the Company's operating results.

Network General products may be considered by certain customers to be capital purchases. An adverse change in general economic conditions could cause certain of the Company's customers to reduce their capital spending, which may adversely affect the Company's revenues.

In January 1994, the Company acquired all of the outstanding stock of ProTools, in part, to acquire ProTools' remote monitoring ("RMON") technology. The RMON market is characterized by rapid technological changes and intense competition. There can be no assurance that Network General's offering of RMON products will be successful or that any specific level of sales will be achieved.

Consolidated Balance Sheets

(Dollars in thousands, except per share amounts)	As of March 31, 1995	1994
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 18,950	$ 4,286
Marketable securities	73,964	51,273
Accounts receivable, net of allowance for doubtful accounts of $1,285 in 1995 and $716 in 1994	18,800	20,438
Inventories	4,226	2,032
Prepaid expenses and deferred tax assets	13,974	13,857
Total current assets	129,914	91,886
Property and Equipment, at cost:		
Demonstration and rental equipment	6,147	5,453
Office and development equipment	20,486	14,634
Leasehold improvements	1,816	1,700
	28,449	21,787
Less – accumulated depreciation and amortization	(15,425)	(10,678)
Net property and equipment	13,024	11,109
Long-Term Investments	52,410	57,480
Other Assets	842	371
	$196,190	$160,846
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 4,186	$ 3,586
Accrued liabilities	9,817	10,215
Deferred revenue	14,375	12,628
Total current liabilities	28,378	26,429
Long-Term Deferred Revenue and Taxes	2,225	2,134
Stockholders' Equity:		
Preferred stock – $.01 par value		
Authorized – 2,000,000 shares		
Outstanding – none	—	—
Common stock – $.01 par value		
Authorized – 50,000,000 shares		
Issued – 22,225,207 shares in 1995 and 20,959,765 shares in 1994	222	210
Additional paid-in capital	109,746	93,110
Retained earnings	64,374	38,963
Less treasury stock, at cost-395,000 shares at March 31, 1995	(8,755)	—
Total stockholders' equity	165,587	132,283
	$196,190	$160,846

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Income

(In thousands, except per share amounts)

For the three years ended March 31,

	1995	1994	1993
Revenues:			
Product	$112,986	$ 96,973	$73,588
Service	26,769	17,927	12,895
Total Revenues	139,755	114,900	86,483
Cost of Revenues:			
Product	23,437	23,546	17,531
Service	8,362	5,490	2,526
Total Cost of Revenues	31,799	29,036	20,057
Gross Profit	107,956	85,864	66,426
Operating Expenses:			
Sales and marketing	47,049	42,906	36,867
Research and development	19,968	15,534	12,178
General and administrative	9,171	7,847	6,966
Restructuring and other operating expenses	—	5,662	—
Total Operating Expenses	76,188	71,949	56,011
Income from Operations	31,768	13,915	10,415
Interest Income, net	5,328	3,338	3,183
Income Before Provision for Income Taxes	37,096	17,253	13,598
Provision for Income Taxes	11,685	5,977	4,953
Net Income	$ 25,411	$ 11,276	$ 8,645
Earnings Per Share	$ 1.14	$ .53	$ .44
Weighted Average Common and Common Equivalent Shares Outstanding	22,313	21,173	19,807

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Stockholders' Equity

For the three years ended March 31,
(Dollars in thousands, except per share amounts)

	Common Stock		Additional Paid-in	Retained	Treasury	
	Shares	Amount	Capital	Earnings	Stock	Total
Balance, March 31, 1992	16,181,923	$162	$ 31,900	$18,949	$ —	$ 51,011
Public offering of common stock at $19.50 per share, net of issuance costs of $2,948	2,500,000	25	45,777	—	—	45,802
Issuance of common stock under the Employee Stock Purchase Plan at $8.29 – $16.15 per share	80,542	1	804	—	—	805
Exercise of stock options at $2.03 – $13.38 per share	225,676	2	1,183	—	—	1,185
Tax benefit of stock options	—	—	903	—	—	903
Lower of cost or market adjustment on long-term investments	—	—	(573)	—	—	(573)
Sale of common stock and conversion of notes payable into common stock	483,291	5	1,779	—	—	1,784
Net income	—	—	—	8,645	—	8,645
Balance, March 31, 1993	19,471,432	195	81,773	27,594	—	109,562
Adjustment to conform year end of pooled Company (Note 2)	—	—	—	93	—	93
Issuance of common stock under the Employee Stock Purchase Plan at $9.56 – $9.67 per share	128,175	1	1,231	—	—	1,232
Exercise of stock options at $.01 – $15.50 per share	687,222	7	4,255	—	—	4,262
Tax benefit of stock options	—	—	3,079	—	—	3,079
Lower of cost or market adjustment on long-term investments	—	—	573	—	—	573
Sale of common stock and conversion of notes payable into common stock	672,936	7	2,199	—	—	2,206
Net income	—	—	—	11,276	—	11,276
Balance, March 31, 1994	20,959,765	210	93,110	38,963	—	132,283
Issuance of common stock under the Employee Stock Purchase Plan at $13.60 – $13.71 per share	119,889	1	1,636	—	—	1,637
Exercise of stock options at $.01 – $20.50 per share	1,145,553	11	10,118	—	—	10,129
Tax benefit of stock options	—	—	4,882	—	—	4,882
Repurchase of common stock at $16.75 – $28.88 per share	—	—	—	—	(8,755)	(8,755)
Net income	—	—	—	25,411	—	25,411
Balance, March 31, 1995	22,225,207	$222	$109,746	$64,374	$(8,755)	$165,587

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows

(In thousands)

	For the three years ended March 31,		
	1995	1994	1993
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 25,411	$ 11,276	$ 8,645
Adjustments to reconcile net income to net cash provided by operating activities:			
Adjustment to conform year-end of pooled company	—	93	—
Depreciation and amortization	6,837	6,174	2,907
Deferred taxes, net	2,599	(5,473)	(3,354)
(Increase) decrease in assets:			
Accounts receivable	1,638	(2,171)	(4,073)
Inventories	(2,194)	2,927	(933)
Prepaid expenses	(2,934)	(416)	2,143
Other assets	(471)	252	184
Increase (decrease) in liabilities:			
Accounts payable and accrued liabilities	(944)	2,892	1,424
Income taxes payable	1,146	(906)	1,687
Deferred revenue	2,056	5,596	2,226
Net cash provided by operating activities	33,144	20,244	10,856
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of held-to-maturity investments	(114,264)	—	—
Proceeds from maturities of held-to-maturity investments	96,643	—	—
(Increase) decrease in marketable securities	—	(28,437)	4,882
(Increase) decrease in long-term investments	—	2,893	(60,291)
Purchase of property and equipment	(8,752)	(7,492)	(6,381)
Net cash used in investing activities	(26,373)	(33,036)	(61,790)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issuance of common stock, net of issuance costs	16,648	8,868	49,629
Repurchase of common stock	(8,755)	—	—
Principal payments on notes and capital lease obligations	—	(271)	(32)
Proceeds from issuance of notes payable	—	209	1,800
Net cash provided by financing activities	7,893	8,806	51,397
Net increase (decrease) in cash and cash equivalents	14,664	(3,986)	463
Cash and cash equivalents at beginning of period	4,286	8,272	7,809
Cash and cash equivalents at end of period	$ 18,950	$ 4,286	$ 8,272
NON-CASH INVESTING AND FINANCING ACTIVITIES			
Capital lease obligations incurred pursuant to the purchase of capital equipment	$ —	$ —	$ 123
Notes payable and accrued interest converted into common stock	$ —	$ 1,940	$ 850
Repurchase of common stock in exchange for note payable	$ —	$ 29	$ —
SUPPLEMENTAL DISCLOSURES			
Cash paid during the year for:			
Interest	$ —	$ 18	$ 37
Income taxes	$ 5,368	$ 9,866	$ 3,935

The accompanying notes are an integral part of these consolidated financial statements. Prior years have not been restated to conform to current year presentations.

Notes to Consolidated Financial Statements

1. Operations

Network General Corporation (the "Company" or "Network General") designs, manufactures, markets and supports software-based fault and performance solutions for managing computer networks. The Company was incorporated in 1986 as a California corporation and changed its state of incorporation to Delaware in fiscal year 1988.

2. Summary of Significant Accounting Policies

Consolidation. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, after elimination of intercompany accounts and transactions.

Acquisition. In January 1994, the Company acquired all of the outstanding common stock and convertible preferred stock and assumed the outstanding stock options of ProTools, Inc. ("ProTools") in exchange for 2,000,000 shares of the Company's common stock. The merger was accounted for as a pooling of interests and, accordingly, the financial statements for prior periods have been restated to include the results of ProTools.

Network General operates and reports on a March 31 fiscal year basis. ProTools operated and reported on a December 31 calendar year basis. The combined statement of income for the fiscal year ended March 31, 1993 combined the statement of income of Network General for the twelve months ended March 31, 1993 with the statement of income of ProTools for the twelve months ended December 31, 1992. Revenues of $1,477,000 and net income of $93,000 of ProTools for the three months ended March 31, 1993 have been excluded from the combined statement of income. The net income of $93,000 of ProTools for the three months ended March 31, 1993 is reflected as an adjustment to retained earnings for fiscal year 1994. Effective April 1, 1993, ProTools' results are reported on a March 31 fiscal year basis along with the results of the Company.

Total charges associated with the merger were approximately $4,903,000. All of these costs were charged against income of the combined Company in the fourth quarter ended March 31, 1994.

Revenues. The Company recognizes product revenues upon shipment of the systems or software. Revenues on rental units under operating leases and service agreements are recognized ratably over the term of the rental or service period. Revenues for training courses are recognized once the course has been completed by the customer. Payments received in advance under such contracts are recorded as deferred revenues. Royalty income is recognized based on the number of copies of software sold by the licensees of the software products. No single customer accounted for more than 10% of revenues in fiscal years 1995, 1994 or 1993.

Export revenues as a percentage of revenues consist of:

	1995	1994	1993
Europe	12%	12%	14%
Asia/Americas	10%	10%	10%
Total Export Revenues	22%	22%	24%

Statement of Cash Flows. For purposes of the consolidated statements of cash flows, the Company considers certificates of deposits, commercial paper and money market funds with an original maturity date of three months or less to be cash equivalents. Marketable securities consist of municipal notes and U.S. Treasury notes with average maturities of less than one year. Long-term investments have maturities ranging from one to six years. Long-term debt investments that will be held to maturity are carried at cost.

Statement of Financial Accounting Standards No. 115. In May 1993 the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities". The Company has adopted the provisions of this statement on a prospective basis in the first quarter of fiscal year 1995, and the effect on its financial statements was not significant. In accordance with SFAS No. 115, the Company has classified all marketable debt securities and long-term debt investments as held-to-maturity, and has accounted for these investments at amortized cost. Accordingly, no adjustment for unrealized holding gains or losses has been reflected in the Company's financial statements.

At March 31, 1995 the amortized cost basis, aggregate fair value and gross unrealized holding losses by major security type were as follows:

(In thousands)	Amortized Cost	Aggregate Fair Value	Unrealized Losses
Debt securities issued by the U.S. Treasury and other U.S. government agencies	$ 23,146	$ 23,146	$ —
Debt securities issued by states of the United States and political subdivisions of the state	103,228	102,414	(814)
	$126,374	$125,560	$ (814)

Inventories. Inventories are stated at the lower of cost (first-in, first-out) or market and include material, labor and related manufacturing overhead. As of March 31, inventories consist of:

(In thousands)	1995	1994
Purchased parts	$1,496	$1,751
Finished goods	2,730	281
	$4,226	$2,032

Property and Equipment. Property and equipment are depreciated and/or amortized using the straight-line method over the following estimated useful lives:

	Life
Demonstration and rental equipment	2 years
Office and development equipment	3 to 5 years
Leasehold improvements	Lease term

Software Development Costs. The Company anticipates capitalizing eligible computer software development costs upon the establishment of technological feasibility, which the Company has defined as completion of a working model. As of March 31, 1995, costs which were eligible for capitalization were insignificant and, thus, the Company has charged all software development costs to research and development expense in the accompanying consolidated statements of income.

Earnings Per Share. Earnings per share is computed using the weighted average number of shares of common and common equivalent shares resulting from outstanding options. Fully diluted earnings per share is the same as primary earnings per share.

3. Concentrations of Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of both short- and long-term marketable debt security investments and trade receivables. The Company has investment policies that limit the amount of credit exposure to any one issuer and restrict placement of these investments to issuers evaluated as creditworthy. Concentrations of credit risk with respect to trade receivables are limited due to the large number of customers comprising the Company's customer base and their dispersion across many different industries and geographies.

4. Accrued Liabilities

As of March 31, accrued liabilities consist of the following:

(In thousands)	1995	1994
Accrued compensation and related taxes	$4,378	$ 3,784
Accrued acquisition and merger costs	353	2,294
Accrued commissions	912	1,186
Accrued income taxes	1,812	666
Accrued sales and use taxes	47	349
Other accrued expenses	2,315	1,936
	$9,817	$10,215

5. Commitments

The Company leases its facilities and certain equipment under noncancelable operating lease agreements. As of March 31, 1995, the minimum future lease payments under these leases are as follows:

Fiscal Year (In thousands)	
1996	$ 3,673
1997	3,418
1998	1,880
1999	1,491
2000	1,357
Thereafter	10
	$11,829

Total rent expense was approximately $4,115,000, $3,854,000 and $2,676,000 in fiscal years 1995, 1994 and 1993, respectively.

6. Employee Savings Plan

In September 1988, the Board of Directors approved an Employee Savings Plan (the "Plan") which is intended to be qualified and exempt from tax under section 401(k) of the Internal Revenue Code. Under the Plan, employees may elect to contribute up to 15% of their gross compensation. The Company contributes to the Plan in amounts determined at the discretion of the Board of Directors. All contributions by the Company are funded currently and vest ratably over three years. All employee contributions are fully vested. Amounts provided by the Company under the plan to date have not been material.

7. Common Stock

Share Repurchase Program. In July 1993, the Company's Board of Directors authorized the Company to repurchase up to 1,000,000 shares of its common stock on the open market to satisfy commitments under its stock option and stock purchase plans. As of March 31, 1995, the Company has repurchased 395,000 shares at an aggregate cost of approximately $8,755,000.

Employee Stock Option Plan. Under the Company's 1989 Employee Stock Option Plan, key employees, employee directors and consultants may be granted either incentive or non-qualified options to purchase common stock at the discretion of the Board of Directors. The Company currently has authorized a total of 7,000,000 shares for issuance under this plan. The exercise price of the stock options may not be less than the fair market value of the common stock on the date of the grant for incentive options or less than 85% of the fair market value of the common stock on the date of the grant for non-qualified options. Employees can receive an 'initial' option grant upon joining the Company, and employees may also be granted 'subsequent' options based upon performance. Prior to July 19, 1993, 'initial' option grants vested ratably each year over a three-year period from the grant date, while 'subsequent' option grants generally vested in a lump sum amount three years after the date on which each 'subsequent' option was granted. In fiscal year 1994, the vesting schedules were amended for any options granted on or after July 19, 1993. Generally, initial option grants vest 25% at the end of the first year and then ratably each month for an additional three years, while subsequent option grants vest ratably each month beginning one month after the grant date for four years. Options issued prior to July 19, 1993 that were not submitted for repricing in fiscal year 1994 continue to vest according to their original schedule.

Option activity under the 1989 Employee Stock Option Plan is summarized as follows:

	Available for Grant	Outstanding	Price Per Share
Balance as of March 31, 1992	1,294,280	1,891,276	$ 4.00 - $ 22.75
Granted	(1,735,543)	1,735,543	$ 8.75 - $ 19.00
Cancelled	625,341	(625,341)	$4.375 - $ 22.75
Exercised	—	(185,364)	$ 4.00 - $13.375
Balance as of March 31, 1993	184,078	2,816,114	$ 4.00 - $ 19.00
Authorization Increase	1,000,000	—	—
Granted	(2,048,847)	2,048,847	$8.625 - $19.875
Cancelled	1,072,269	(1,072,269)	$4.375 - $ 19.00
Exercised	—	(548,845)	$ 4.00 - $ 15.50
Balance as of March 31, 1994	207,500	3,243,847	$4.375 - $19.875
Authorization Increase	2,500,000	—	—
Granted	(1,677,538)	1,677,538	$14.25 - $ 28.44
Cancelled	789,263	(789,263)	$ 7.50 - $ 20.50
Exercised	—	(939,792)	$4.375 - $ 20.50
Balance as of March 31, 1995	1,819,225	3,192,330	$4.375 - $ 28.44

Of the outstanding options, 353,669 were exercisable as of March 31, 1995.

During fiscal year 1994, the Company cancelled 692,232 options at $9.75 to $19.00 per share and reissued the same number of options at the then current fair market value of $9.125 per share with vesting restarting on the new grant date. In addition, some of the option grants that were submitted for repricing in fiscal year 1994 had their vesting schedules amended. Non-officer employees who submitted their initial option grant for repricing had no changes made to the original vesting schedule. Non-officer employees who submitted their subsequent option grants for repricing had their vesting schedules changed so that they now vest in a lump sum at the end of four years, where they had previously vested in a lump sum at the end of three years. Officers who submitted initial option grants for repricing had their vesting schedule changed so that they now vest ratably each year over a four-year period, where they previously vested ratably each year over a three-year period. Officers who submitted subsequent option grants for repricing had their vesting schedules changed so that they now vest in a lump sum at the end of four years, where they previously had vested in a lump sum at the end of three years.

During fiscal year 1993, the Company cancelled 464,097 options at $12.88 to $22.75 per share and reissued the same number of options at the then current fair market value of $10.25 per share. No change to the vesting schedules of participants was made, other than that vesting restarted on the new grant date. Officers of the Company were excluded from participation in the fiscal year 1993 option repricing.

Outside Directors Stock Option Plan. In April 1989, the Company established the 1989 Outside Directors Stock Option Plan, whereby outside directors may be granted non-qualified options to purchase common stock. The number of shares of common stock authorized for issuance under this plan is 460,000. The exercise price of the stock option may not be less than the fair market value

of the common stock on the date of the grant. Each outside director is granted an initial option grant of 20,000 shares upon election to the Board and an option grant of 5,000 shares each subsequent year. Prior to July 19, 1993, initial option grants vested ratably each year over a three-year period from the grant date, while subsequent option grants generally vested in a lump sum amount three years after the date on which each subsequent option was granted. In fiscal year 1994, the vesting schedules were amended for any options granted on or after July 19, 1993. Generally, initial option grants now vest 25% at the end of the first year and then ratably each month for an additional three years, while subsequent option grants now vest ratably each month between the third and fourth year after the grant date. Directors were excluded from participating in both the fiscal year 1994 and the fiscal year 1993 option repricing. As of March 31, 1995, 105,000 options are available for future grants and 185,000 options are outstanding, of which 90,000 shares were exercisable at an average price of $12.86 per share. Options issued prior to July 19, 1993 continue to vest either ratably over a three-year period or in a lump sum amount at the end of three years.

Employee Stock Purchase Plan. The Company has authorized 700,000 shares of common stock for issuance under the 1989 Employee Stock Purchase Plan. Employees may elect to withhold up to 10% of their compensation for the purchase of the Company's common stock. The amounts withheld are used to purchase the Company's common stock at a price equal to 85% of the fair market value of the stock on the first or last day of a six-month offering period, whichever is lower. The Company issued 119,889 shares at an average price of $13.65 per share in 1995, 128,175 shares at an average price of $9.61 per share in 1994 and 80,542 shares at an average price of $9.99 per share in 1993.

Common Stock Award Plan. In June 1989, the Board of Directors approved the 1989 Common Stock Award Plan and reserved 120,000 shares for issuance thereunder. Under this plan, awards are made to independent sales representatives and consultants based upon individual sales performance criteria. The shares are issued at fair market value and the related value of the shares are charged to sales and marketing expense over the vesting period. The shares generally vest over three years and the Company can reacquire any unvested shares upon termination of the individual's relationship with the Company. No shares of common stock were awarded under this plan in fiscal year 1995. As of March 31, 1995, the number of shares that have been awarded under this plan is 29,468, all of which are fully vested.

ProTools, Inc. Stock Option Plan. In connection with the acquisition of ProTools in January 1994, the Company assumed the outstanding stock options of ProTools. At the time of the merger, 272,830 equivalent ProTools incentive stock options were outstanding. As of March 31, 1995, 5,731 incentive stock options were outstanding, all of which are fully vested and exercisable at $.67 per share. The Company does not intend to grant any additional incentive stock options under this plan.

Common Stock Reserved for Future Issuance.
As of March 31, 1995:

1989 Employee Stock Option Plan	5,011,555
1989 Outside Directors Stock Option Plan	290,000
1989 Employee Stock Purchase Plan	261,150
1989 Common Stock Award Plan	90,532
1990 ProTools, Inc. Stock Option Plan	5,731
	5,658,968

8. Income Taxes

In February 1992, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes". The Company has adopted the provisions of this Statement on a prospective basis in the first quarter of fiscal year 1993 and the effect on its financial statements, upon adoption, was not significant.

(In thousands)	1995	1994	1993
Income before provision for income taxes:			
Domestic	$36,535	$17,038	$13,360
Foreign	561	215	238
	$37,096	$17,253	$13,598

Provision for income taxes:			
Federal			
Current payable	$11,311	$ 6,868	$ 5,336
Deferred tax asset	(605)	(2,270)	(1,476)
Non-current deferred	(1,673)	(554)	(221)
Total Federal	9,033	4,044	3,639
State			
Current payable	2,876	2,092	1,380
Non-current deferred	(489)	(328)	(163)
Total State	2,387	1,764	1,217
Foreign	265	169	97
Total Provision	$11,685	$ 5,977	$ 4,953

The sources of deferred tax assets as of March 31 are as follows:

(In thousands)	1995	1994
Deferred revenue currently recognized for tax purposes	$ 1,163	$ 3,920
Reserves and accruals not currently deductible for tax purposes	3,532	2,963
State taxes, not currently deductible for Federal tax purposes	310	675
Depreciation	2,702	2,966
Operating loss carryover of ProTools	2,042	2,189
Total deferred tax asset	9,749	12,713
Valuation allowance	(2,042)	(2,189)
Net deferred tax asset	$ 7,707	$10,524

The valuation allowance consists of the operating losses of ProTools, a wholly owned subsidiary acquired in January 1994, in a transaction accounted for as a pooling of interests. The operating losses are subject to certain annual limitations as a result of the acquisition and may expire before the Company can utilize them. The Company believes sufficient uncertainty exists regarding the realizability of these losses on a separate entity basis, and accordingly, a valuation allowance has been established.

The provision for income taxes differs from the amounts obtained by applying the Federal statutory rate to income before taxes as follows:

	1995	1994	1993
Statutory Federal income tax rate	35.0%	35.0%	34.0%
State income taxes, net of Federal benefit	5.1	5.7	5.7
Permanent differences	(8.6)	(10.6)	(7.2)
Reduction due to tax law changes	—	(3.8)	—
Operating losses of ProTools not realized	—	4.5	3.9
Merger and acquisition costs	—	3.8	—
	31.5%	34.6%	36.4%

9. Notes Payable

In June, July and October 1992, ProTools borrowed $300,000, $500,000 and $1,000,000, respectively, in aggregate principal from certain of its then current stockholders. ProTools issued promissory notes bearing interest at 9% due and payable within 179 days from issuance or upon conversion into shares of common stock. In July 1993, the notes were converted into common stock.

10. Related Party Transaction

In connection with the acquisition of ProTools, Network General assumed certain royalty obligations to a company whose principal stockholder was also an officer of Network General. The royalty obligation called for royalty payments through December 31, 1999 or until $920,000 in aggregate royalties had been paid. In fiscal 1995, Network General negotiated a lump sum payment of approximately $572,000 to this company in full settlement of all royalties owed under this agreement. The prepaid royalty is being expensed as a cost of goods sold as related revenues are recognized.

Report of Independent Public Accountants

To Network General Corporation:

We have audited the accompanying consolidated balance sheets of Network General Corporation (a Delaware corporation) and subsidiaries as of March 31, 1995 and 1994, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended March 31, 1995. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Network General Corporation and subsidiaries as of March 31, 1995 and 1994, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 1995 in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN LLP

San Jose, California
April 26, 1995

Corporate Information

Board of Directors

Harry J. Saal
Chairman of the Board

Leslie G. Denend
President and
Chief Executive Officer

Leonard J. Shustek
Network General Fellow

Dr. Howard Frank
Senior Fellow
Wharton School of Business

Gregory M. Gallo
Member
Gray Cary Ware & Freidenrich
A Professional Corporation

Laurence R. Hootnick
Consultant

Charles J. Abbe
Senior Vice President
Corporate Development
Raychem Corporation

Senior Management

Leslie G. Denend
President and
Chief Executive Officer

James T. Richardson
Senior Vice President
Corporate Operations
Chief Financial Officer
Secretary

Richard H. Lewis
Senior Vice President
Worldwide Field Operations

Michael H. Kremer
Senior Vice President
Product Development

Legal Counsel

Gray Cary Ware & Freidenrich
A Professional Corporation
Palo Alto, CA 94301

Independent Public Accountants

Arthur Andersen LLP
San Jose, CA 95110

Transfer Agent

Inquiries regarding lost certificates, change of address, transfer of ownership or other stock account matters should be directed to:
Chemical Mellon Shareholder Services
50 California Street, 10th Floor
San Francisco, CA 94111
(800) 647-4273

Stock Listing

Network General's common stock is traded on the Nasdaq National Market under the symbol NETG. As of May 30, 1995 there were 435 stockholders of record.

Dividend Information

Network General has never declared cash dividends and presently intends to continue this policy.

Investor Relations

To receive further information regarding the Company's operations, or to request copies of the 1995 Form 10-K, which is available at no charge, please contact:
Investor Relations
Network General Corporation
4200 Bohannon Dr.
Menlo Park, CA 94025
(415) 473-2000

Senior Management

James T. Richardson

Richard H. Lewis

Michael H. Kremer

United States Sales Offices

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Designed and Produced by Jacobs Fulton Design Group, Palo Alto, CA

Network General

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